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Intelligence

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International Economic & Energy Weekly

25X1

18 November 1983

Secret

DI IEEW 83-046
18 November 1983

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Note: The *International Economic and Energy Weekly* will not be published next week. The next issue will be on 2 December 1983. 25X1

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International Economic & Energy Weekly

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Synopsis

Perspective—*The IMF's Conditionality Dilemma* 25X1

The IMF must soon decide how stringent new or revised economic adjustment policies should be for several key LDC and East European debtors with programs currently or soon to be under review. The Fund is caught in a delicate position of trying to maintain the cooperation of both debtors and creditors to effect an orderly international adjustment to the debt problem. 25X1

International Financial Situation: The IMF Funding Squeeze 25X1

This article is part of a special series on the economic and political aspects of the international financial situation. The article examines the uncertainty over the availability of future IMF resources that is jeopardizing the Fund's pivotal role in managing the international debt problem. 25X1

International Financial Situation: Bankers' Attitudes Toward LDC Lending 25X1

This is another article in the special series on the economic and political aspects of the international financial situation. It examines the willingness of commercial banks to meet LDC financing needs in the coming months.

Japan: Status of Bank Lending to LDCs 25X1

Although some Western analysts have accused Japanese bankers of being uncooperative on LDC debt issues, our analysis shows that they have grudgingly pulled their weight in reschedulings and are expanding their international lending. Most new LDC lending, however, is going to relatively well-off East Asian countries. 25X1

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Venezuela: Postponing IMF Discipline 25X1

Economic conditions in Venezuela have deteriorated rapidly in recent months, and President Herrera's unwillingness to submit to an IMF program has stalled progress in rescheduling foreign debt. Caracas has averted cash difficulties during a period of declining oil revenues by resorting to tough foreign exchange controls, but at the expense of economic performance. 25X1

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Chile: A Risky Shift to Growth-Oriented Policies 25X1

Santiago since last spring has moved to assuage popular discontent by gradually stimulating the economy after the steep decline in 1982. 25X1

Sudan: The Economy on the Eve of Nimeiri's Visit 25X1

Sudan's economy is beginning to show some progress, but the country remains deeply in debt and in need of foreign assistance. President Nimeiri will probably seek US support for his position in negotiations with the IMF as well as new aid during his talks in Washington next week. 25X1

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18 November 1983

Perspective

The IMF's Conditionality Dilemma [redacted] 25X1

The IMF must soon decide how stringent new or revised economic adjustment policies should be for several key LDC and East European debtors with programs currently or soon to be under review. The Fund is caught in a delicate position of trying to maintain the cooperation of both debtors and creditors to effect an orderly international adjustment to the debt problem. On the one hand, the Fund risks losing the cooperation of debtors in carrying out needed economic reforms if they judge IMF demands as too harsh and likely to spur social and political unrest. On the other hand, creditors are looking to the Fund to oversee needed reforms in these countries before they will provide new capital. [redacted] 25X1

Some Latin American debtors are questioning the efficacy of current IMF prescriptions, and we expect them to demand more lenient adjustment programs in the months ahead. Although the Fund's rescue programs have averted a major default so far, most Latin leaders believe they have not reaped the benefits they expected from these programs:

- New commercial and official funds activated by IMF agreements have covered little more than past debt servicing. 25X1
- Despite the IMF's "seal of approval," [redacted] new commercial bank lending to Latin America nearly ceased in first-half 1983. 25X1
- Simultaneously, IMF-mandated adjustments—devaluations, removal of subsidies, spending cutbacks—are now causing more inflation, unemployment, and reductions in living standards than Latin leaders and the IMF expected.

The situation is aggravated by growing social strains that have created political problems in implementing tough IMF programs. [redacted] 25X1

At present Brazil, Argentina, Chile, and Venezuela are leading the effort for a softening of IMF conditionality:

- Domestic resistance to austerity prevented the Brazilian Government from obtaining congressional approval for the tough wage restraints initially demanded by the IMF. A compromise wage bill has been approved, and, [redacted] the Brazilians have warned the IMF that failure to sanction the wage compromise could force the government to declare a debt moratorium. 25X1

- Argentina's newly elected government will be under pressure to drive a hard bargain in order to claim it is able to handle the debt problem more effectively than the military government.

- In late October, Chile's economic team bowed to popular discontent and announced intentions to ease fiscal policy in order to boost economic recovery in 1984.

- According to recent Embassy reporting, the new Venezuelan government—widely expected to be led by Jaime Lusinchi—also intends to spur economic growth and will not easily accept an IMF-mandated stabilization program. [redacted] 25X1

While recognizing debtor concerns, the Fund must also weigh those of commercial lenders. Debt rescheduling and new financial assistance are, in most cases, conditional on the implementation of adjustment policies. While less restrictive IMF programs may meet the internal political needs of the borrower, they could fall short of what lenders view as minimally acceptable. At the same time, in drawing up its programs, the Fund must take into account uniformity of treatment among members. More flexible policies for Latin debtors would almost certainly spark demands from other financially troubled countries. [redacted] 25X1

The IMF also has to factor in the views of the governments of the major industrial countries when working up its lending strategy. Presently, the IMF's flexibility is limited because of uncertainty over its own financial resources. Even if the quota increase is approved, several industrial countries have expressed concern that the Fund has gone beyond its traditional role as a source of temporary balance-of-payments financing and argue that resources will have to be better conserved in 1984-85. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

OPEC Production Remains Above Ceiling

OPEC production in October averaged 19 million b/d, 1.5 million b/d above the cartel's self-imposed ceiling. Saudi output remained 1 million b/d above its implicit quota of 5 million b/d as Riyadh continued its war relief assistance to Iraq in the form of crude sales to Baghdad's customers. [redacted] 25X1

[redacted] 25X1

OPEC: Crude Oil Production, 1983 *Million b/d*

	Quota	September [a]	3rd Qtr [a]	October [a]
Total	**17.5**	**19.2**	**18.7**	**19.0**
Algeria	0.725	0.6	0.6	0.6
Ecuador	0.2	0.2	0.2	0.2
Gabon	0.15	0.2	0.2	0.2
Indonesia	1.3	1.4	1.4	1.4
Iran	2.4	2.6	2.5	2.4
Iraq	1.2	0.9	1.0	1.0
Kuwait	1.05	0.9	1.0	1.1
Libya	1.1	1.1	1.1	1.1
Neutral Zone	[b]	0.5	0.5	0.4
Nigeria	1.3	1.2	1.4	1.3
Qatar	0.3	0.3	0.3	0.4
Saudi Arabia	5.0 [c]	6.2	5.6	6.0
United Arab Emirates	1.1	1.2	1.2	1.2
Venezuela	1.675	1.7	1.7	1.7

[a] Preliminary.
[b] Neutral Zone production is shared equally between Saudi Arabia and Kuwait and is included in each country's production quota.
[c] Saudi Arabia has no formal quota; it acts as swing producer to meet market requirements.

[redacted] 25X1

[redacted] 25X1

[redacted] According to the US Embassy, Doha plans production at this level for the remainder of the year to avoid using foreign exchange reserves to pay debts and to finance planned spending programs. Nigeria has also stated its intention to increase its crude production through yearend. [redacted] 25X1

OPEC Pressing for Higher Production Quotas

The OPEC production quota assigned to Venezuela in March reportedly has begun to impair Caracas's ability to generate much-needed revenues. According to the head of Venezuela's national oil company, Caracas has been able to meet its revenue requirements and comply with its 1.7-million-b/d quota by drawing down inventories on the order of 150,000 b/d to keep exports high. The official claims that these drawdowns have reduced Venezuela's inventories to such a low level that the country will need to increase production before yearend in order to build inventories for 1984. Venezuela is not alone in its desire to raise its production quota. Recent press reports indicate that Tehran intends to ask OPEC at its meeting next month to increase the Iranian quota by one-third from the current level of 2.4 million b/d to 3.2 million b/d. Both Caracas and Tehran have been critical of Saudi Arabia for producing well above its implied quota. Riyadh's unwillingness to curb output probably has spurred other OPEC members to seek higher quotas. Barring a strong upturn in demand, OPEC will be hard pressed to accommodate these pressures. [redacted] 25X1

Pressures To Relax Nigeria's Gas Flaring Ban

Nigeria's National Petroleum Corporation (NNPC) reportedly is urging Lagos to grant exceptions to its ban on natural gas flaring that will become effective 1 January 1984. Although initially supportive of the ban, NNPC now officially opposes it because, without a means to transport gas to domestic consumers or export options, the Corporation must assume about 70 percent of the costs of reinjecting the gas. A senior Nigerian oil official has told the US Embassy in Lagos that NNPC lacks the financial resources needed to pay for reinjection. Last year Nigeria flared about 1 billion cubic feet a day of gas worth $5.5 billion, according to oil industry sources. Because Nigeria's gas is produced in association with crude oil, which accounts for over 90 percent of foreign exchange earnings, we believe the government will relax the ban on flaring rather than forgo needed oil earnings. [redacted] 25X1

West German Energy Demand Rises

For the first time since 1979, West German energy demand in the third quarter rebounded over year-earlier levels, largely in response to the economic recovery. According to preliminary data, primary energy consumption in the third quarter increased 1.6 percent compared with a decrease of 2 percent in the first six months of the year. With the exception of a 1-percent decline in oil use, all fuels registered gains during the recent quarter. Natural gas consumption increased by 7 percent while use of hydropower was up 18 percent. Coal and nuclear power showed small increases, largely reflecting increased electricity demand. [redacted] 25X1

Price Discounting of Polish Coal

[redacted] brokers in the United Kingdom and West Germany are offering Polish coal at prices some 10 to 15 percent below prices quoted by the Polish Government. The brokers contend that the Polish Government has allotted 500,000 metric tons of coal this year to a foreign trade organization that will market the coal in the West and use the hard currency to buy goods for use as incentives for miners. The lower priced Polish 25X1

coal most likely will supplant US and other coal sales in Western Europe. In the first six months of this year, Poland's share of the West European coal import market rose to 16 percent compared with 10 percent a year earlier. The US share dropped from 55 percent to 44 percent. [redacted] 25X1

International Finance

Mexico Shifting Economic Policy for 1984

Mexico City is planning to shift its economic policies next year to emphasize economic recovery rather than price and exchange rate stability, according to a US Embassy report. The government apparently feels a relaxation in austerity is needed to avoid political unrest. The proposed 1984 economic program, now under discussion with the IMF, reportedly calls for a minimum increase of 2 percent in GDP, while halving inflation on a December-to-December basis to 40 percent. Because Mexico City anticipates a continuing decline in private-sector economic activity, the government believes it is necessary to spark the economy by boosting federal spending. The first public indication of next year's program will come later this month when de la Madrid presents the 1984 budget to Congress. [redacted] 25X1

To give Mexico City some leeway in policy planning, the government is negotiating with the IMF for flexibility in next year's target for deficit spending. Because we believe that Mexico City's tax base is still deteriorating, it is our assessment that the government will not be able to boost GDP while reducing the deficit to 5.5 percent of GDP in 1984 as agreed with the IMF last year. In particular, new public-sector price adjustments—including those for transportation and public utilities—will be difficult to implement. Increased government deficits would boost the growth in the money supply, putting renewed pressure on the peso. [redacted] 25X1

We believe this proposed policy shift endangers Mexico's economic stabilization program. If reflating the economy results in wide divergence from IMF performance targets, we believe de la Madrid would find it necessary to clamp down on the economy late in 1984 to ensure continued access to foreign financing. Such a start-stop course could drag out economic recovery and undercut the government's longer term objective of creating enough employment to satisfy a rapidly growing labor force. [redacted] 25X1

Mexican Private-Sector Debt Rescheduling

[redacted] $11.6 billion of a total of $16 billion in private-sector foreign debt was entered into the FICORCA program, most just before registration closed on 25 October. The program is designed to help private debtors with rescheduling by guaranteeing them access to subsidized foreign exchange for future debt service obligations. We agree with US Embassy sources, however, that far less than half of the amount registered has been formally rescheduled. The remainder was registered in FICORCA under a last-minute waiver allowing rescheduling to be worked out later. We expect a substantial portion ultimately will not be rescheduled as some private firms will be unwilling to accept lenders' terms while others will go bankrupt. [redacted] 25X1

Philippine Financial Developments

[redacted] 25X1

The US Embassy reports that stocks of fuel oil have dropped to about a week's supply as a result of the shortage of foreign exchange. Manila has asked the United States to help by providing fuel oil from Clark Air Force Base and Subic Bay Naval Base. Running out of fuel oil, half of which is used by the government-owned National Oil Company to generate electricity, would result in a major political setback for the government. Even with temporary assistance from the United States, the government could face fuel shortages by January if banks fail to renew commercial import financing. [redacted] 25X1

More Loan Difficulties for Colombia

Bogota's growing troubles on the borrowing front augur a liquidity crunch early next year. [redacted] banks have withdrawn 25X1
from participation in a $225 million loan because of legal disagreements, causing Colombia to lose $60 million in new credit. [redacted] 25X1
[redacted] banks are resisting the placement of a $400 million loan for 25X1
the country's electric utility. Moreover, despite World Bank cofinancing guarantees, Colombia's lenders have been hesitant to grant any new development loans for the ambitious 1983-86 investment program and were noncommital to the Colombian presentation at its Consultative Group Meeting last month in Paris. With foreign borrowings cut and Colombia's payments deficit widening, we believe there is a more than 50-percent chance that Colombia will be forced to seek debt rescheduling early in 1984. [redacted] 25X1

Ecuadorean Financial Update

Ecuador has recently obtained new loans, but its financial position remains strained. The US Embassy reports that Quito's creditor banks recently disbursed $215 million of the new $431 million credit line as part of the 1983 IMF financial rescue agreement. These funds, however, are not enough to eliminate arrearages—now an estimated $450-500 million—and to meet current debt servicing obligations. Meanwhile, an IMF mission is visiting the country this month to complete its performance evaluation report and to set economic targets for 1984. According to US Embassy reports, Quito has succeeded in limiting the 1983 public-sector deficit to 4.2 percent of GDP and

has also implemented the required interest rate and trade measures. Inflation—running at 60 percent, compared with 25 percent in 1982—remains a problem because of wage increases and removal of price controls and subsidies. Unless the IMF grants a waiver, Quito's failure to meet the 35-percent inflation target may jeopardize disbursement of the remaining $44 million of the $170 million IMF standby loan. In an attempt to gain additional financing, President Hurtado has already announced Ecuador's intentions to renegotiate its 1984 debt at terms similar to those of the 1983 debt rescheduling agreement. 25X1

Costa Rican Problems With IMF

Costa Rica has narrowly averted a cutoff of IMF funds, but problems remain in securing a new standby agreement for 1984. The Fund has agreed to extend an October waiver on a 1-percent tax on foreign exchange remittances through November. This follows the unification and devaluation of the two-tiered exchange rate, a move that complies with the IMF's December performance targets. Negotiations to conclude a new standby agreement for 1984, however, have been postponed again because San Jose has had difficulty in fulfilling other commitments made to the Fund. IMF officials are most concerned about the government's proposed 1984 budget—especially the 25-percent increase in central government expenditures. In addition, the Fund remains concerned about the adverse impact of the still overvalued exchange rate on export performance. Although the administration is considering ways to cut next year's proposed $3 billion budget and the Costa Rican Congress is likely to repeal the remittance tax by 1 December, the conclusion of a new standby agreement could be delayed by at least a few months until these actions are taken. 25X1

Global and Regional Developments

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1984 Agricultural Trade Outlook

International trade in most major food items declined in marketing year (MY) 1983 despite falling prices, and we expect little improvement next year. In many LDCs, imports will be constrained by foreign exchange limitations. Agricultural imports by the Communist countries, especially the USSR and China, will level off because of improved domestic production. In order to cope with this weak demand situation, US competitors are subsidizing sales and offering favorable financial terms to move surpluses. As a result, US exports of key items most likely will continue to bear the brunt of the soft market. Using projections by USDA and other trade sources, we expect:

- Competition will intensify in the world wheat market, as foreign producers generate large surpluses. The US market share may fall by 2 percentage points to 38 percent, the lowest level since MY 1973.

- The world soybean market will be characterized by larger carrying stocks, lower production, and constant demand. As a result of recent oilseed price increases, Brazil and Argentina are likely to expand production and gain a larger share of soybean product exports. The US share of the soybean market will fall from 87 percent to 80 percent, while soybean meal exports will decline by 5 percentage points to 25 percent.

World and United States: Agricultural Production and Exports *Million metric tons*

	Production			Exports		
	1983	1984 [a]	Change From Previous Period *(percent)*	1983	1984 [a]	Change From Previous Period *(percent)*
Wheat [b]	479.5	484.2	1.0	98.4	99.4	1.0
United States	76.4	65.5	−14.3	39.9	38.1	−4.5
Coarse grains [c]	779.6	681.1	−12.6	89.3	90.5	1.3
United States	255.5	139.5	−45.4	53.3	56.9	6.8
Soybeans [c]	93.9	77.3	−17.7	28.3	24.6	−13.1
United States	60.7	41.3	−32.0	24.6	19.6	−20.3
Soybean meal [c]	61.1	57.4	−6.1	21.7	21.0	−3.2
United States	24.2	21.1	−12.8	6.4	5.2	−18.8
Meat	104.3	105.0	0.7	10.3	10.5	1.9
United States	26.9	26.5	−1.5	0.5	0.5	0
Sugar [d]	100.0	94.7	−5.3	28.1	26.4	−6.0
United States	5.3	5.2	−1.9	0	0	0

[a] Estimated.
[b] July/June marketing year.
[c] October/September marketing year.
[d] September/August marketing year.

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- Competition from Brazil and the EC for poultry markets in 1984 could result in a slight decline in the US market share.

- The near-term trade outlook for US coarse grains will remain strong at least until the coarse grain crops of Argentina, Australia, and South Africa begin to enter the market in March 1984. Deteriorating crop conditions in some importing countries and the new US-USSR Long-Term Grain Agreement may strengthen import demand. As a result, the US share of the coarse grain market should increase from 60 percent to 63 percent. 25X1

EC Budget Talks Stalled

At a Special Council meeting on 9-11 November, EC foreign, finance, and agricultural ministers failed once again to agree on proposals for reforming the Community's budget and the Common Agricultural Policy. The United Kingdom repeated demands for a permanent reduction in its budget payments to the Community, and other members argued the necessity of increasing EC revenues. The EC Commission's proposal that financial contributions be recalculated in a way that would cut the United Kingdom's rebate caused London to threaten again to block an increase in Community tax revenues. EC Foreign Ministers will meet again on 28 and 29 November in an attempt to reach agreement on a reform package which can be tabled at the EC summit on 4-6 December in Athens. 25X1

Prospects for agreement before the summit are not good. The Community is facing a growing financial crisis because of rising agricultural costs and limited resources, but EC members remain divided on how to solve the problem. The United Kingdom and West Germany, the only net financial contributors to the Community, will continue to insist that the budget burden be spread more evenly before they will agree to agricultural reforms or increases in EC revenues. The continuing disarray on agricultural policy will prevent the Community from dealing effectively with agricultural trade disputes at the high-level meeting next month with the United States.

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National Developments

Developed Countries

Israeli Inflation Skyrockets

Consumer prices rose at an annual rate of 895 percent in October—by far the largest monthly increase in Israel's history—because of the large shekel devaluation and the boost in most government-controlled prices by 50 percent. Prices will continue to rise sharply—although probably not as fast as in October—for the remainder of the year, resulting in an inflation rate for 1983 of 180 to 200 percent. Large increases in the cost of electricity and water will force manufacturers to boost prices of their goods, and the government raised the prices of controlled items by another 15 to 30 percent earlier this month.

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Officials of the Histadrut, the large trade union organization, had demanded an advance on the next quarterly cost-of-living adjustment—scheduled to be paid on 1 February—even before the October price rise was announced this week. The Histadrut, the Manufacturers' Organization, and the Finance Ministry agreed earlier this month to form tripartite committees to study a number of issues, including the feasibility of advancing the cost-of-living adjustment. A Histadrut official told a US Embassy officer that Histadrut leaders are optimistic about getting an advance payment because Finance Minister Cohen-Orgad would otherwise have refused to establish the committee. Public outcry over the large price hikes could force Cohen-Orgad to agree to a partial cost-of-living adjustment before 1 February even though this would mitigate the impact of higher prices on domestic demand. Cohen-Orgad has publicly stated that private consumption will have to be reduced over the next year to reduce inflation and improve Israel's foreign payments outlook. 25X1

Turkey's Prospects Under Ozal

The victory of Turgut Ozal's Motherland Party in the general election on 6 November portends continuity in Turkey's economic policy. Ozal—almost certain to be the prime minister of the civilian government slated to take office later this month—is generally credited with conceiving and implementing Turkey's market- and export-oriented economic stabilization program in 1980. The plan has reduced inflation, sparked a resumption of economic growth, and reduced the current account deficit. As Prime Minister, Ozal will probably reinforce the measures. In his election campaign, Ozal called for the further development of the export sector and the encouragement of private savings and investment. He has promised to continue the fight against inflation, open the economy to foreign investment, and reduce the large public sector. 25X1

Given Ozal's philosophy, Turkey's economic prospects seem relatively bright. Ozal's emphasis on increasing exports and foreign investment should boost Turkish economic development and help the country deal with balance-of-payments pressures when rescheduled debt payments begin falling due in late 1984. His inclination toward tight monetary policies will help control inflation. Ozal may face some resistance to his program from President Evren, who will still retain substantial power under the Constitution adopted last year. Although Evren generally supports the 1980 austerity program, he is more favorably inclined toward state intervention in the economy and may frown on Ozal's plans to move quickly to a more market-oriented economy. 25X1

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EC Commission Forecasts Slow 1984 Growth

The recently released EC Commission *Annual Economic Report* forecasts a sluggish recovery for the 10 EC economies, with GNP growth averaging only 1.4 percent in 1984. The Commission points to the continuing efforts of most governments to trim their budget deficits and cut inflation rates as major causes for next year's slow growth. Moreover, it expects that several key industries, such as steel and shipbuilding, will continue to contract because of declining trade competitiveness. [redacted] 25X1

EC Commission GNP Growth Forecasts *Percent*

	1982	1983	1984
European Community	**0.4**	**0.6**	**1.4**
West Germany	−1.0	0.7	2.1
France	1.8	−0.3	0.4
United Kingdom	1.5	2.8	2.2
Italy	−0.3	−0.8	1.5
Belgium	1.0	−0.9	0.6
Denmark	3.4	2.2	1.2
Greece	NEGL	−0.2	1.5
Ireland	1.2	0.5	1.8
Luxembourg	−1.1	−2.4	−1.0
Netherlands	−1.6	0.3	NEGL

[redacted] 25X1

Although all major components of the Ten's GNP are expected to grow, the Commission believes that no one sector will post significant advances. Tax hikes, increases in joblessness in all 10 countries, and average real wage gains of only 0.4 percent are expected to hold down private consumption. The Commission believes investment will pick up slightly from 1983's depressed levels, partly because of anticipated declines in interest rates. The strength of the US dollar should help West European exports sales at the expense of US manufacturers. [redacted] 25X1

Less Developed Countries

Malaysia's Trade Swing

Kuala Lumpur reported a $143 million merchandise trade surplus in the first half of 1983, up $400 million from the same period last year. The improved performance stems largely from an export boom based on higher prices and increased production of key commodities. The price of palm oil, Malaysia's third-largest export earner, has almost doubled over the past year, and rubber prices are up sharply because of increased demand in industrial nations. Output of crude oil, the country's largest export earner, has risen nearly 25 percent—more than offsetting a 15-percent cut in the price of Malaysian crude last March. In addition, the export of liquefied natural gas to Japan, which began last January, will generate about $415 million in foreign exchange this year. The improving trade account should hold the 1983 current account deficit well below last year's record $3.4 billion and slow the rapid growth of the country's $12 billion foreign debt. [redacted] 25X1

Economy of Southern Lebanon Remains Depressed

The recent decision by the occupying Israeli Defense Forces (IDF) to reopen the coastal road at the Awwali River bridge will not ameliorate economic problems in southern Lebanon. The decision was made after a general strike protesting Israeli security measures shut down most businesses and schools throughout Lebanon on 8 November. Even with the reopening of the coastal road, transportation bottlenecks continue to constrain economic activity in the area. [redacted] the IDF continues to limit access to the port at Sidon to certain favored shippers, making it difficult to move agricultural produce to regional markets. Moreover, a mile-long detour on the coastal road—diverting traffic away from the area where the IDF headquarters was blown up—and an Israeli requirement that all truckers obtain Israeli travel permits to cross the Awwali bridge will continue to hamper essential food and fuel shipments to and from Beirut. [redacted] 25X1 25X1

Communist

China Projects Record Grain Harvest

Chinese officials have announced that the 1983 grain harvest will surpass last year's record harvest of 353 million metric tons. We estimate the harvest at about 370 million tons, an increase of 50 million tons over three years ago. Although the bumper harvest is causing transportation and storage problems, we believe it will lend support to Beijing's current rural reform policies that provide better incentives to farmers. The harvest also will lessen the demand for grain imports, while record harvests of cotton and soybeans will reduce China's need to import these commodities in 1984 as well. [redacted] 25X1

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USSR Illegitimate Births Encouraged

Contrary to official policy, Soviet demographers appear to be promoting unwed motherhood in western regions of the USSR. One scholar recently said that "illegitimacy is understandable as a way to raise the birth rate in regions where it is low—that is, the central provinces of the RSFSR, the Ukraine, and the Baltic republics." Another scholar cited pregnancy out of wedlock as a poor reason for abortion. These statements probably reflect official concerns about low birth rates in the Slavic and Baltic regions. There are roughly 500,000 illegitimate births a year in the USSR, about 10 percent of all registered births, with the highest rates in Siberia and the Far East. 25X1

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International Financial Situation: The IMF Funding Squeeze [redacted] 25X1

This article is part of a special series focusing on the economic and political aspects of the international financial situation. [redacted] 25X1

Uncertainty about the availability of future IMF resources is jeopardizing the Fund's pivotal role in managing the international debt problem. The IMF [redacted] currently has only about $3 billion in uncommitted resources, and that amount is likely to decline to less than $1 billion by April 1984. Because of the financial squeeze, the IMF has suspended funding of new standby and extended programs calling for more than 100 percent of a member's quota. It is counting on ratification of a $30 billion increase in members' quotas—$16 billion of which will be in hard currencies—by 30 November, although sufficient member approval by this target date is uncertain. We believe that, if the IMF funding problem persists for several months, commercial banks could perceive an unraveling of the current debt strategy and move to scale back further their LDC financing. Economic repercussions would be especially severe for large LDC and East European debtors—Argentina, Venezuela, Yugoslavia, Egypt, the Philippines, Nigeria, Romania, and Hungary—which are currently or expected to soon be negotiating Fund arrangements to deal with 1984 financing needs. [redacted] 25X1

The Resource Gap

Part of the reason for the Fund's overriding concern for adequate resources is its conservative policy of providing for liquidity well in advance of loan disbursements. At the time a standby or three-year extended arrangement is agreed upon, the IMF sets aside the full amount of the commitment. Actual disbursements, however, may be less than the commitment because disbursements are sometimes withheld as a result of noncompliance with program targets or occasionally as a result of a reduction in members' financing needs. On the other hand, the IMF must ensure members' access to Fund resources since members with large quotas can almost automatically draw down their reserve quota. [redacted] 25X1

IMF Projections of Resource Use, October 1983 Through April 1984 *Billion SDRs* [a] 25X1

	Oct-Dec 1983	Jan-Apr 1984
Uncommitted ordinary resources from members' quotas [b]	6.7	4.8
Usable funds at beginning of period	14.5	10.8
Repayments during period	0.3	0.3
Undrawn loan commitments	4.8	4.1
Estimated new commitments and other outflows in train	3.3	2.2
Borrowed resources [b]	−4.1	−4.1
Special Finance Facility and Enlarged Access Resources credit lines [b]	3.5	1.8
Undrawn commitments	7.6	5.9
Uncommitted resources [b]	**2.6**	**0.7**

[a] 1 SDR=US $1.05.
[b] End of period.

[redacted] 25X1

While the IMF's overall uncommitted resources have dwindled to less than $3 billion, it is actually in deficit on the resources it borrows from members to augment quota contributions. At the end of September, commitments of borrowed resources exceeded available credit lines from the Supplementary Financing Facility and Enlarged Access

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Sources of IMF Funds

Subscriptions or quotas are the main source of IMF funds. The Board of Governors is required to conduct quota reviews at least every five years. On 31 March 1983, the Board completed the Eighth General Review of Quotas and authorized nearly a 50-percent increase in aggregate Fund quotas from $64 billion to $95 billion. Twenty-five percent of each member's quota is payable in reserve assets—either SDRs or hard currencies—and 75 percent is payable in the member's domestic currency. Each member has until 30 November 1983 to consent to the increase; new quotas take effect when consent has been received from members representing at least 70 percent of present total quotas. [redacted]

The IMF also is authorized to borrow funds in any currency and from any source, official or private, provided that the member whose currency the Fund wishes to borrow agrees to the transaction. To date, the IMF has restricted its borrowing to official entities:

- *Since 1962 the Fund has had standing arrangements—called the General Arrangements to Borrow (GAB)—with the governments and central banks of 10 industrial country members under which it can borrow substantial amounts of their currencies to finance drawings by any of the 10. The Fund is awaiting approval of a proposal to enlarge the GAB from $6.7 billion to $17.8 billion.*

- *In 1974-75 the IMF borrowed $7.4 billion from 15 official creditors and created two oil facilities to help LDC members finance sharply higher oil import bills. Loans are no longer made under these facilities, although members continue to pay charges and make repayments under them.*

- *In early 1979, 14 official lenders provided $8.2 billion to establish the Supplementary Financing Facility. These funds, all of which were committed within two years, went to members with serious balance-of-payments problems in the form of additional financing under standby and extended arrangements.* 25X1

- *In May 1981, the Fund concluded an agreement with Saudi Arabia to borrow up to $8.4 over two years, with the possibility of a further $4.2 billion in the third year. These funds, together with $1.4 billion from 18 other countries, constitute the Fund's Enlarged Access Resources with which the Fund has been able to continue to aid those members requiring resources in larger amounts and for longer periods than available under regular credit tranche policies.* [redacted] 25X1

Resources by over $4 billion. The Fund is attempting to borrow $3 billion from the Bank for International Settlements (BIS) and a matching amount from Saudi Arabia to cover both the borrowed resources deficit and $2 billion in new allocations it expects to make early next year. The effort to date has been unsuccessful largely because European governments believe any BIS credit agreement would reduce pressure on the US Congress to ratify the quota increase, according to press reports. [redacted]

Impact on LDC and East European Debtors

The shortage of IMF resources is likely to make it much more difficult for those debtors without Fund arrangements to fill their 1984 financing requirements. The Fund has been instrumental in assembling major financing packages for debt-burdened LDCs by tying new commercial bank loans, official credits, and debt relief to its standby and extended loans, which are disbursed if quarterly economic targets are met. In this manner, borrowing from the Fund not only provides some immediate liquidity, but, more importantly, it has become the necessary "seal of approval" in restoring the debtor's ability to draw on world capital markets and to obtain debt restructuring. Commercial bank credit and debt relief associated with IMF agreements frequently have far exceeded the value of the IMF commitment. [redacted] 25X1

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As of late September, 43 LDCs and East European countries had standby or extended arrangements with the Fund, including 13 of the 20 largest LDC debtors. Three large debtors—Venezuela, Nigeria, and Egypt—are negotiating programs that are not covered by current IMF resources:

- Venezuela continues to talk with the IMF on obtaining funds from several Fund assistance programs, but differences remain over conditionality. Agreement, if at all, is unlikely until after the expected inauguration of a new administration in February. According to the Embassy, a senior economic adviser to leading presidential contender Lusinchi believes that conditional IMF funding is unnecessary given Venezuela's $11 billion reserve level and recent import cuts. Bankers would prefer, however, that Caracas submit to an IMF adjustment program before they proceed with debt refinancing of the $18 billion due before the end of 1984. Bankers recently approved a fourth extension to an original 90-day grace period on principal repayments.

- Nigeria is also involved in difficult negotiations with the IMF and is seeking $2.7 billion in Fund resources over three years. Settlement of Lagos's large short-term trade arrearages, however, is likely to be a precondition to any IMF agreement or additional bank credits. The US Embassy attributes Lagos's chronic inability to make these payments on time to the Central Bank's bureaucratic ineptitude rather than a shortage of funds.

- Egypt would like to reschedule its official debt, especially US foreign military sales payments. Creditors, particularly the United States, are not receptive to the request for debt rescheduling unless it is made in a multilateral forum and in conjunction with an IMF program. An IMF mission is due in Cairo this month to work on a standby arrangement. Heavy government subsidies on basic commodities are likely to be a contentious issue in the negotiations.

In addition, under its current policy the IMF cannot fully fund requests for new or revised programs already made by the Philippines and Hungary and expected from Argentina, Romania, and Yugoslavia:

- In September the Philippines was declared out of compliance with its current one-year standby arrangement and ineligible to draw its next $50 million disbursement. Manila recently declared a 90-day moratorium on principal repayments of all maturities to commercial banks. Prime Minister Virata is negotiating a new and larger $630 million Fund arrangement that would include the existing $225 million undrawn balance and leave $405 million contingent upon the IMF's own availability of resources.

- Hungary's one-year standby arrangement expires in January 1984. Improvement in the current account is falling well short of expectations, and Budapest has launched discussions with the Fund on an 18- to 24-month stabilization program with $600 million in credits. More IMF support is crucial if Hungary is to line up enough bank financing to cover large debt service payments in 1984-85.

- Although Argentina's 15-month $1.6 billion standby arrangement is due to expire in April 1984, disbursements have been suspended since last July because of payments arrears and the existence of unacceptable exchange and import restrictions. Some $500 million in contingent commercial bank loans have also been held up, although banks have offered to release the funds if they are applied toward repayment of arrears. Argentina has been forced into a de facto moratorium with debt renegotiations suspended until the new civilian government can participate. While an undrawn balance of close to $950 million under the current arrangement may be eligible toward funding of a new program, we estimate Argentina's needs and severe imbalances will require a much larger and comprehensive program.

Selected Debtors: IMF Arrangements, New Commercial Bank Loans, and Debt Rescheduled, 1983

Million US $[a]

	Date of Arrangement	Expiration Date	Amount of Agreement	Undrawn Balance[b]	1983 New Bank Loan Tied to IMF Arrangement	Debt Rescheduled in 1983
Standby Arrangements						
Argentina	Jan 1983	Apr 1984	1,575	945	1,500	7,500
Chile	Jan 1983	Jan 1985	525	397	1,300	3,400
Costa Rica	Dec 1982	Dec 1983	97	39	0	1,500
Hungary	Dec 1982	Jan 1984	500	175	0[c]	0
Philippines	Feb 1983	Feb 1984	330	225	0	0
Romania	Jun 1981	Jun 1984	1,158	492	0	800
South Korea	Jul 1983	Mar 1985	605	504	0	0
Sudan	Feb 1983	Feb 1984	180	80	0	2,700
Thailand	Nov 1982	Dec 1983	285	129	0	0
Yugoslavia	Jan 1981	Dec 1983	1,745	250	600	1,900
Extended Arrangements						
Brazil	Feb 1983	Feb 1986	4,450	4,320	4,400	4,700
India	Nov 1981	Nov 1984	5,250	2,415	0	0
Ivory Coast	Feb 1981	Feb 1984	509	121	0	0
Jamaica	Apr 1981	Apr 1984	500	78	0	150[d]
Mexico	Jan 1983	Dec 1985	3,580	3,160	5,000	22,000
Pakistan	Dec 1981	Nov 1983	965	198	0	0
Peru	Jun 1982	Jun 1985	683	470	450	1,400

[a] SDRs converted at rate of 1 SDR=$1.05.
[b] As of 31 July 1983.
[c] Hungary has received $400 million in two Eurodollar syndications this year.
[d] Under negotiation.

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- Romania's disbursements under a three-year standby arrangement have been suspended since August because of Bucharest's refusal to raise energy prices as recommended by the IMF. At stake are two disbursements totaling $195 million in second-half 1983. Bucharest continues to talk with the Fund in an effort to salvage the current arrangement. Romania's continuing financing needs suggest that IMF funding will be necessary beyond June 1984 when the current standby is due to expire.

- In mid-September Yugoslavia concluded its much-delayed debt refinancing agreement with Western bankers. The agreement refinanced $1.9 billion in medium- and short-term debt, provided $600 million in new credits, and ensured disbursement of the last $250 million available under a three-year IMF standby arrangement. Despite improvement in its current account, Yugoslavia will enter next year with low foreign exchange reserves and few credits in the pipeline to bridge its financing gap. 25X1

Other LDCs negotiating new or revised Fund arrangements include Sudan, Zaire, Bolivia, Costa Rica, Madagascar, Somalia, and Liberia. These members have a total external debt of $23 billion,

ranging from almost $9 billion for Sudan to less than $1 billion for Liberia. Should these LDC debtors be unable to line up IMF credit, arrearages would almost certainly grow and additional de facto debt moratoriums set in. Moreover, the chance to effect much-needed economic adjustment measures would slip by. Zaire, for example, has implemented politically unpopular austerity measures as a precondition to a new standby program it had expected to sign in late October. It now faces delays in obtaining these funds, and the government will be under heavy political pressure to ease its belt-tightening efforts. The standby was also a prerequisite for official multilateral debt rescheduling and IBRD consultative group efforts. [redacted]

Impact on the International Financial System

A delay in approval of the IMF quota increase beyond first-quarter 1984 could have severe repercussions for the international financial system if bankers and LDC debtors perceive a lack of commitment and cooperation on the part of the major industrialized nations and an unraveling of the current debt strategy. Smaller amounts of IMF assistance will require more financing from other parties or even stronger adjustment efforts on the part of LDC debtors if debt repayments are to be kept current. Without the IMF program, we believe commercial banks would be inclined to reduce, not increase, their credit lines. Reduced external financing in turn would most likely result in a weakening of politically unpopular adjustment efforts in the short term. [redacted] 25X1

Even with the quota increase, the IMF will be under pressure in 1984-85 to conserve its resources. At the recent Fund annual meeting, some members expressed concern that the Fund has gone beyond its traditional role as a source of temporary balance-of-payments financing. They are advocating reduced member access to IMF funds and increased conditionality of those drawings that currently are relatively easy to obtain, such as the Compensatory Financing Facility, which finances export shortfalls. [redacted] 25X1

Outlook

If the IMF's 30 November deadline for approving the quota increase is not met, the Fund will most likely ask for an extension for ratification into early next year, hoping approval could be obtained before the end of the Fund's fiscal year on 30 April. 25X1

[redacted] 25X1

[redacted]. We expect the IMF to continue to ration resources until the new quota contributions are approved. [redacted] 25X1

The IMF could borrow from private capital markets, although this would require approval from those members whose currency is being borrowed. 25X1
The United States and many European governments have long been opposed to commercial market funding because they believe that over the longer term the practice would reduce the IMF's financial flexibility. Moreover, since the commercial banks would prefer to lend to the less-credit-risky IMF at this particular time, such a move probably would be perceived as a bailout of the banks. [redacted] 25X1

[redacted] 25X1

International Financial Situation: Bankers' Attitudes Toward LDC Lending

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This article is part of a special series focusing on the economic and political aspects of the international financial situation. 25X1

We believe there is a danger that almost all new bank lending to financially troubled LDCs in 1984 will go to a handful of major debtors, forcing many other countries to curtail imports. We also believe bankers will gauge the level of their lending to LDCs by the outcome of key debtors' negotiations with the IMF over the next several months. While the sheer size of the debt problems of Mexico, Brazil, and Argentina obliges bankers to find some workable solution that includes new loans, they feel no such compulsion to continue new lending to smaller LDC debtors. The money center banks in the United States are concerned mainly with protecting existing loans to the major debtors, and many regional and foreign banks will make new loans only after heavy persuasion from the IMF, the large banks, and governments. 25X1

Bank Lending to Latin America

The international financial community has become increasingly concerned over financial conditions in Argentina because of uncertainty over whether the government will both adhere to an IMF austerity program and request reasonable terms on public debt reschedulings. Press reports indicate that the Argentine bank advisory group has set 30 November as the deadline for commercial banks to disburse $500 million, representing the first tranche of a $1.5 billion credit formally approved in late 1982. The group is pushing to make the first $500 million disbursement so that the government can pay off upcoming principal payments and a portion of arrearages. We believe that further disbursements of new bank loans beyond the $500 million tranche will depend on the new government's coming to an agreement with the IMF. The agreement could take the form of either renegotiating the existing program, which expires in April, or negotiating a new program. A new IMF program would probably require several months of preparation, causing Argentine arrearages to grow. 25X1

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Bank Attitudes Toward Major Asian Borrowers

[redacted]

The money center banks do not expect that other major Asian borrowers will experience serious bank financing problems during 1984, [redacted] Several smaller US regional banks, however, are concerned that the financial problems in the Philippines could have a spillover effect on South Korea and Indonesia. A large portion of South Korea's debt is short term; the government has scaled back a number of development projects, however, and expects that gross external borrowing from banks in 1984 will be on the order of $4 billion instead of the $6 billion it had projected earlier. Indonesia has also cut back on development projects and substantially devalued the rupiah. We believe Indonesia's gross borrowing requirement will not exceed $2.5 billion in 1984. [redacted]

Prospects for Smaller Financially Troubled Debtors

A concern held by several financial analysts is that although banks may feel compelled to lend to the larger LDC debtors, they may cease new lending to smaller debtors whose external payments problems do not threaten the international financial system. For example, smaller debtors in Latin America—Ecuador, Bolivia, and Costa Rica—may be unable to pressure banks for new loans. These countries would then be forced to further adjust their external balances by cutting imports. As a result, their economies would experience low growth throughout the 1980s, leading to increased domestic discontent and more pressure on governments and official agencies to come to their financial rescue. [redacted]

[redacted]

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Japan: Status of Bank Lending to LDCs [redacted] 25X1

In the wake of recent LDC debt reschedulings, some Western financial analysts have accused Japanese bankers of being uncooperative, both by failing to pull their weight in the rescheduling process itself and, more broadly, by cutting back lending to LDCs. Our analysis shows that Japanese banks have been grudgingly cooperative in reschedulings and are expanding their international lending. Most new LDC lending, however, is going to relatively well-off East Asian countries. A legacy of bitterness among Japanese bankers over some Latin American rescheduling operations could cause them to be less forthcoming in the future unless pressed by the Japanese Government. [redacted] 25X1

[redacted] 25X1

Building Up LDC Loan Portfolios

Until 1978, Ministry of Finance (MOF) regulations allowed Japanese banks to engage in syndicated offshore lending only on a case-by-case basis. Once these regulations were relaxed, the Japanese banks—whose financial exposure to LDCs was relatively light—rapidly expanded their international lending. Opportunities in developing countries were considered especially attractive. More than one-third of the new medium- and long-term loan commitments Japanese banks made during 1980-82 were to non-OPEC LDCs; more than half of this amount went to Latin American borrowers.

[redacted] 25X1

Bailing Out Mexico and Brazil

In the immediate aftermath of Mexico's August 1982 moratorium announcement, Japanese bankers apparently were prepared to curtail sharply lending to LDCs. The MOF stepped in, however, to ensure that Japanese banks would cooperate in rescheduling efforts. The MOF reportedly hoped to head off criticism from foreign governments, primarily the United States, that Japan was not being helpful on debt issues. To encourage Japanese banks to participate, the MOF waived—in Mexico's case—the limit of 20 percent of a bank's capital that could be tied up in loans to any one country. In early 1983 the Ministry allowed banks to set aside reserves amounting to 5 percent of the value of their loans to 25 financially troubled countries. This new directive effectively expanded the ceiling on Japanese international lending. [redacted] 25X1

Ministry of Finance Guidance on Offshore Lending

Despite a 1980 change in Japanese law freeing international capital transactions in principle, the Ministry of Finance (MOF) has retained control over certain aspects of offshore lending. In setting semiannual guidelines, the Ministry's primary objectives have been to encourage sound banking practices and to prevent offshore lending from damaging Japan's balance of payments.

In addition to overseeing the volume of medium- and long-term offshore lending, Ministry guidance usually includes:

- *Limits on the amount that can be outstanding to a single country relative to the bank's capital and reserves. At present, the limit for city banks is 20 percent. This means that the larger banks may extend medium- and long-term loans totaling approximately $500 million to each foreign country.*
- *A cap on the ratio of total foreign currency assets to reserves. This has been raised regularly and now stands at 15.*
- *The minimum share of foreign currency funding that must be in instruments with specific maturities.*
- *The maximum share Japanese banks can take of any given syndicated Eurocurrency loan.*
- *Instructions on how to deal with loan requests from countries considered bad credit risks by the MOF. In September 1982, 16 countries were counted as risky, including the Philippines, several Latin American countries, and most of the Soviet Bloc.*

Given the close relationship between the MOF and the banks, the Japanese Government was better able than most creditor governments to police adherence to rescheduling agreements. The Japanese banks, unlike their counterparts in West Germany and Italy, in early August were current on their money market commitments to Brazil, 25X1

Bankers in Tokyo, 25X1

however, believe that the formula governing individual banks' shares in a $4 billion loan for Brazil forced the Japanese to bear an unfairly heavy burden. The formula was based only on outstanding medium- and long-term loan balances. Many Japanese bankers felt a formula based on total exposure would have been more just since it would reflect the relatively low level of Japanese exposure in short-term credits. The failure of many US and European banks to live up to their short-term commitments to Brazil reinforced the perception of inequity. 25X1

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Increased Lending but More Caution

Japanese cooperation in reschedulings, even if grudging, and willingness to make new loans outside of Latin America have contributed to an increase in their share of international lending. In the final quarter of 1982, the Japanese made 35 percent of worldwide medium- and long-term international loans—up sharply from previous levels. The relatively high level of Japanese international lending activity evident in late 1982 apparently is continuing. 25X1

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Japanese banks have become more discriminating, however, on lending to LDCs. Loans to Latin LDCs now appear confined mainly to refinancing operations. One notable exception is Japanese participation in a recent $275 million loan for Panama, where Japanese businessmen hope to expand operations and eventually to participate in building a sea-level canal.

Southeast Asian borrowers have been the primary LDC beneficiaries of the banks' desire to check the growth of their exposure in Latin America. The Japanese dominated the Asia-Pacific syndicated offshore loan market in the first half of 1983. According to *Asian Finance*, seven Japanese banks were among the top 20 managers of loans to that region. Thailand and Malaysia appear to be especially attractive to Japanese bankers now because their external debts are relatively moderate, as are their debt service-to-export ratios.

Outlook

We expect Japanese banks will continue to be major actors in the LDC loan market in the coming year, although most new lending will continue to be confined to East Asian LDCs. There is strong commercial pressure on the banks to increase overseas lending, in part because of the poor domestic investment climate and continuing large current account surpluses. As the pace of liberalization in the domestic capital market has quickened in recent years, profit margins on domestic lending have been compressed. A surge in investment spending—which would tend to widen margins—is not in the cards, according to business surveys. Against this backdrop, international business will look attractive. We do not believe the MOF will block expansion of banks' offshore activity by issuing restrictive guidance.

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How active the banks will be on rescheduling will depend on Finance Ministry pressure and on which countries are involved. The MOF still has powerful inducements at its disposal to convince Japanese banks to be cooperative. For instance, under pressure from the banks, it is considering making the new bad debt reserves tax exempt. The positions held—and pressure on Tokyo exerted—by the US Government will be crucial factors, we believe, in Ministry decisions on how hard to push the banks on rescheduling matters. 25X1

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Venezuela: Postponing IMF Discipline [redacted]

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Economic conditions in Venezuela have deteriorated rapidly in recent months, and President Herrera's unwillingness to submit to an IMF program has stalled progress in rescheduling foreign debt. Caracas has averted difficulties during a period of declining oil revenues by resorting to tough foreign exchange controls, but at the expense of economic performance. We expect a 2.5-percent drop in output this year accompanied by rising unemployment and a sharp fall in private investment. Even with a new administration after the elections in December, we doubt Venezuela's willingness to take the tough adjustments necessary to deal with its foreign financial problems. Jaime Lusinchi—widely expected to win the presidency in December—is backpedaling on earlier commitments to seek IMF support. We believe lack of an IMF program will impede debt rescheduling and could lead to a foreign financing crisis in the first half of next year. [redacted]

The Financial Impasse and Its Costs

No progress has been made to date regarding the restructuring of $18 billion in principal payments and interest due foreign banks by the end of 1984. Caracas continues to resist bankers' demands to adopt an IMF stabilization program in return for refinancing. To avert a financial confrontation, the foreign bank advisory committee has extended Venezuela's payments deferrals, the latest being a 90-day extension on public debt principal repayments that expires in January 1984. [redacted]

Although the government has been conducting discussions with the IMF, Caracas has shown itself intransigent on the Fund's suggestions regarding economic adjustment measures. According to Embassy and press reporting, the IMF has stipulated that Caracas must cut public-sector spending by nearly 10 percent to create a budget surplus compared with an estimated deficit equal to 4 percent of GDP for this year. The IMF also wants the government to remove price controls, allow market-determined interest rates, devalue and unify exchange rates, discard import barriers, and eliminate debt arrearages. According to Embassy reporting, the government is resisting Fund belt-tightening requirements that it perceives as too politically costly. Moreover, Caracas believes IMF assistance may be unnecessary and announced it will not seek a $1.1 billion Compensatory Financing Facility from the IMF. [redacted] 25X1

Rather than accept an IMF program, Caracas has staved off cash problems through its own restrictive policies, particularly limiting access to foreign exchange. Tough controls have stopped capital flight. 25X1
Additionally, a three-tier exchange system and import restraints have improved the trade accounts. According to the Embassy, Caracas will most likely cut imports 35 percent this year thereby generating a trade surplus in excess of $6 billion. The improvement in the trade accounts will enable the government to nearly eliminate its current account deficit; last year it was $3.5 billion. This has eliminated the need for any new commercial borrowings. Moreover, by resorting to commercial arrearages, Caracas has increased its foreign exchange reserves to some $11 billion, according to a banking source, compared with about $8.8 billion in February. 25X1
[redacted] 25X1

Caracas has avoided submitting to lender-imposed austerity, but has failed to avoid harming its domestic economic performance. The tough exchange controls have resulted in shortages of raw 25X1

material imports, forcing many firms to suspend production. While inflationary pressures have been held at bay by strict price controls, businessmen have been squeezed between fixed prices and rising costs, precipitating growing numbers of bankruptcies. Consequently, economic activity is likely to decline at least 2.5 percent this year, resulting in rising joblessness. Unemployment has risen to an estimated 11 percent compared with 8 percent last year; Embassy sources now estimate that 40 percent of the population has trouble meeting basic subsistence needs. [redacted]

The economic contraction plus price and exchange controls have also resulted in sharp declines in private and public investment over the last year. Construction has fallen by 27 percent, in part reflecting the drop in new industrial plant building. Petroleum industry investment also contracted by 5 percent in the wake of reduced oil earnings. The public-sector-controlled Petroleos de Venezuela (PDVSA), which accounts for about $14 billion or 95 percent of oil exports, is experiencing a liquidity crisis. PDVSA has been forced to make large budget cuts, especially in oil development projects, which have added to the ranks of the unemployed. [redacted]

The present government has made it difficult for the private sector to make debt repayments. The Herrera administration's failure to release dollars to the business community has resulted in an estimated $400-600 million in private debt arrears. Despite a recent decree that was established to streamline private debt payments, Central Bank President Diaz Bruzual continues to impede the release of dollars. These delays are harming the business sector's international creditworthiness thereby impeding access to new foreign funds. [redacted]

Challenges Ahead

Venezuela's present administration will pass on difficult economic problems to the next government, widely expected to be led by Jaime Lusinchi and the Accion Democratica (AD) party. Lusinchi will be expected to fulfill high expectations from both the rural and labor sectors—historically the backbone of the AD. He will need to make basic policy adjustments if the economy is to achieve long-term growth. For example, although petroleum revenues have declined by 30 percent since 1981, government spending has continued to grow. Little effort has been made to cut costly subsidies or public-sector inefficiencies necessary to bring spending in line with available resources. [redacted] Venezuela is likely to face a continued slump in domestic activity without changes in present exchange rate and price control policies. Until progress is made in rescheduling the external debt, financial uncertainties will persist. [redacted]

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In late October, Lusinchi released the blueprint of his economic program. It is a mix of austerity and pump priming. Although Lusinchi recognizes the need to implement austerity, he is promising more government assistance to reactivate housing and agricultural development projects. Moreover, his program shows internal inconsistencies. Lusinchi pledges to keep inflation down but insists he will devalue to unify the exchange rates. He wants to make the public sector more efficient, but without risking higher unemployment because of his political debt to labor for their electoral support. The high priority he gives to attracting new foreign investment is likely to collide with his call for greater state participation in the economy. [redacted]

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The pressures from Lusinchi's economic staff and party leaders to place Venezuela's economy on a course of rapid growth will militate against easy acceptance of an IMF-mandated stabilization program. One of Lusinchi's senior economic advisers has warned that Caracas will not accede to any IMF requirement to reduce the level of the public-sector deficit. Moreover, leaders of his political party indicate that because of fears of social unrest, prices such as that of gasoline will not be allowed to rise to levels recommended by the Fund. According to US Embassy sources, if Lusinchi proceeds along his present course, there will be no early agreement with the IMF or international banks. [redacted]

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Dim Prospects

There is a growing consensus that Venezuela's economic and financial problems will dissipate in the coming year. The Venezuelan private sector generally believes that the present recession is likely to worsen because they anticipate further delays in needed economic adjustments. The Venezuelan-American Chamber of Commerce, for example, has already projected negative growth for 1984 with inflation rising to some 30 percent—prices probably would rise 50 percent in the absence of price controls. Businessmen do not expect prompt relief from onerous price or exchange controls in 1984 and are braced for an upsurge in bankruptcies. Consequently, business leaders project unemployment may reach 25 percent. Although some international bankers are softening their demands that Caracas accept an IMF program, we expect ongoing difficulties in external debt renegotiations. With its access to foreign credit cut, Caracas will remain vulnerable to new external shocks that could quickly precipitate a foreign exchange crisis. 25X1

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Chile: A Risky Shift to Growth-Oriented Policies

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Santiago since last spring has moved to assuage popular discontent by gradually stimulating the economy after the steep decline in 1982. Political pressure has been building for improving the unemployment picture. In late October, Chile's economic team announced its intentions to ease fiscal policy in the hopes of engineering a stronger recovery in 1984. Although we believe there is a good chance the IMF and other external creditors will support Santiago's new policies, there are major risks. Faster growth will translate into higher prices and some worsening in the foreign payments position next year. Furthermore, a worsening of domestic violence could upset government plans and lead to economic chaos.

The Miracle's Demise

After five years of boom that resulted from Chile's adherence to free market policies, the economy began to nosedive in mid-1981. The drop in demand for Chilean exports and intense import competition contributed to the abrupt slowdown. Unemployment rose from 8 to 11 percent and was accompanied by increased business failures. The press increasingly criticized the government's failure to respond to worsening conditions, but the economic team insisted on battling inflation.

Santiago's reluctance to ease restrictive policies caused the Chilean economy to sink deeper into recession during the first half of 1982. New austerity measures were enacted in March, and, after President Pinochet came under strong pressure to relieve growing unemployment, he replaced the economic team in late April. The policy adjustments that followed, however, were insufficient to break the economic slide. Santiago only slowly increased public works spending, thereby failing to slow the growth in unemployment. Monetary tightness did not ease until the fourth quarter, causing interest rates to remain high. 25X1

The mishandling of the exchange rate devaluation further weakened the economy. The abrupt end of the fixed exchange rate policy in June 1982 only served to undermine public confidence in the government's economic policy and spurred capital flight. Experimentation with several different exchange rate systems added to public concern about disarray in economic policy making. By midyear, Chile's foreign creditors had become disenchanted, and the government was forced to begin negotiations to arrange an IMF standby to shore up banker confidence. 25X1 25X1

Economic output declined 14 percent in 1982 compared with growth of about 6 percent a year during 1976-81. Unemployment doubled to 25 percent. The 22-percent decline in industrial activity caused business failures to soar; bad debts rose to about 50 percent of bank capital and reserves. Rapid devaluations and agricultural setbacks resulted in a doubling of inflation to 21 percent. The economic tailspin heightened social discontent and resulted in a further loss of confidence in the President, his economic team, and the free market model. 25X1

At the same time, Chile's external payments difficulties mounted. Debt servicing became more onerous because of the falloff in exports, the series of devaluations, and the decline in foreign lending from $4.4 billion in 1981 to $940 million in 1982. Capital flight and the slowdown in foreign loans drained international reserves by nearly one-third to $2.6 billion. One of the few bright spots was the halving of the current account deficit to $2.4 billion as recession caused imports to fall. 25X1 25X1

Financial Crisis

Santiago early in 1983 attempted to lay the foundation for improved domestic economic performance while simultaneously trying to deal with its foreign financial crisis. The government had concluded a new IMF standby arrangement in early January. Chile's economic team also tried to shore up the domestic financial system by purchasing bad debts from the banks.

The hope for quick improvements was dashed by an abrupt confrontation with foreign bankers. On 13 January, Santiago announced a banking holiday and intervened in the operation of several banks while liquidating others. The government failed to guarantee the foreign debts of these institutions, however, and foreign bankers reacted by cutting all new lending and demanding repayment of maturing loans. The cessation of credit and resurgent capital flight drained nearly $1 billion in reserves by the end of January. The government responded by declaring a 90-day moratorium on foreign debt amortization payments on 31 January. These developments took Chile out of compliance with its new IMF standby agreement and put IMF resources on hold.

Economic Reconstruction

In March, the authorities enacted an emergency plan to stabilize domestic financial markets and gradually revive the economy:

- Refinancing terms for domestic debts were liberalized and cheaper financing for housing was made available.
- Gas taxes were increased and tariffs were doubled to finance the moves in a manner consistent with the IMF program. These policies somewhat restored domestic confidence and laid the foundation for a gradual upturn in economic activity 25X1

Santiago extended the foreign payments moratorium in April. Santiago also requested $1.3 billion in new medium-term money, the restoration of $1.2 billion in short-term credits, and the rescheduling of maturing loans from its foreign bankers. Negotiations were also under way to gain release of embargoed IMF loans. 25X1

Political Discontent Brings Economic Concessions 25X1

The government responded to popular protests that began in early May with selective repression in the streets and some limited concessions, first on economic policy and then on the political front. Santiago in June announced increased spending for housing and health care, hiked public salaries 5 percent, and allowed homeowners to defer some mortgage payments. In late June the government announced a program to aid small farmers; in July the administration slapped a 15-percent countervailing duty on some imports to help industrialists. In August the government reassessed its political strategy, and negotiations were begun with moderate opposition leaders. To support the political 25X1 dialogue, the economic team announced new public spending that would create 160,000 jobs. 25X1

Cautious reflation has enabled Santiago to comply with IMF commitments. Higher tax revenues have prevented a sharp runup in the public deficit. Monetary expansion has slowed dramatically since the first quarter. By early August, the visible progress in the economy enabled Santiago to conclude its foreign financial rescue program. The IMF approved the revised stabilization program, releasing $100 million in suspended funds, and foreign bankers approved Chile's financial rescue program. 25X1

On the domestic front, industrial production rose in the second quarter. Unemployment dropped from a peak of 25 percent to about 18 percent and is projected to fall to 15 percent by the end of the year. Despite some recovery, the lingering effects of previous austerity measures caused inflation to moderate during the summer. Capital flight abated with the return of steady economic policies. Chile posted an $830 million trade surplus through August, helped by a rebound in noncopper exports and tough import cuts. [redacted]

Demands for Economic Expansion

Despite cautious reflation, public pressure continues to build for more stimulative economic policies. According to the US Embassy, the business community is pressing for a strong economic recovery. Press reports consistently emphasize economic grievances, especially high unemployment, as the cause of violent demonstrations in poor neighborhoods. [redacted]

Political maneuvering within the government has intensified for easier economic policies. [redacted] Interior Minister Jarpa—Pinochet's most influential political adviser—is urging the President to replace the economic team to clear the way for more expansion. Jarpa believes that such policies would aid him in negotiations with opposition elements on the scheduled transition to civilian rule. [redacted]

Bowing to these pressures, the present economic team has announced plans to lower unemployment in 1984. The Embassy reports that Santiago has requested the IMF to allow a public-sector deficit of at least 5 percent of GDP in 1984, up from 2.3 percent this year. The government contends that increased public spending will be necessary for 4- to 5-percent growth, but the larger deficit will not accelerate inflation or jeopardize other targets. [redacted] Chile would require up to $1 billion in new foreign loans in 1984 to finance this plan. [redacted]

Prospects

The government's announced economic programs combined with recent political concessions and the onset of summer vacations in December should temporarily ease the political crisis. The government's ability to sustain recovery depends on the willingness of the IMF and foreign creditors to provide financial support. In our view, the IMF will probably accede to Santiago's request for a less stringent austerity program. Should this occur, increased spending would trigger an economic rebound of upwards of 5 percent and a further decline in unemployment. Inflation, however, would accelerate and the current account deficit would widen, perhaps to $1.5 billion. [redacted] 25X1 25X1

Even if the IMF consents to Santiago's expansionary fiscal policies, there remains the risk that other factors affecting the dialogue with the opposition could cause the agreement to collapse. A series of labor stoppages, especially in the mines, would disrupt production and stall the recovery. Hoarding could cause some shortages of consumer staples, putting upward pressure on prices. Political unrest also would trigger renewed capital flight that would drain foreign reserves, undermine banker confidence, and produce a foreign funding gap. Ultimately, polarization and spiraling violence could force the military to remove Pinochet from office. [redacted] 25X1 25X1 25X1 25X1 25X1

Implications for the United States

US firms have been hard hit by Chile's economic crisis in the wake of the rapid expansion of bilateral commercial ties since 1976. US banks hold $6 billion in Chilean loans and have experienced a disruption in debt repayments. Moreover, US exports contracted by 40 percent to $800 million last year as Chilean economic activity plummeted. [redacted] 25X1 25X1 25X1

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Any substantial shift from market-oriented policies toward more nationalistic economic policies would further damage US commercial interests. US businessmen remain vulnerable to new restrictions on foreign investment, especially in the minerals sector. At worst, Santiago could nationalize foreign investment, causing large losses for US companies.

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Sudan: The Economy on the Eve of Nimeiri's Visit [redacted] 25X1

Sudan's economy is beginning to show some progress, but the country remains deeply in debt and in need of foreign assistance. The government has made progress in bringing its finances under control and is expecting a boost from oil revenues in 1986. Major economic reforms are being required. In particular, the IMF—supported by aid donors—is urging the government to relinquish some state control of economic activity to the private sector, as part of a 1984 standby aggreement. President Nimeiri will probably seek US support for his position in negotiations with the IMF as well as new aid during his talks in Washington next week. [redacted]

Recent Developments

Real GDP fell by 2 percent in the fiscal year ending in June. The decline was primarily the result of drought that reduced rain-fed agricultural production by 20 percent. Notwithstanding the generally poor agricultural performance, there were some bright spots. A bumper cotton crop was 29 percent above the previous year's harvest, reflecting improved government incentives. Strong performances also were registered in the sugar and cement industries. Most industries and services, however, continue to suffer from shortages of imported spare parts and electric power disruptions. [redacted]

In the last year the government has made some progress under the direction of an IMF standby agreement in controlling budget and current account deficits. Government revenues kept pace with inflation, while real government spending fell, primarily because the nominal amount of funds transferred to regional governments remained unchanged despite 40-percent inflation. The current account deficit narrowed as exports—largely cotton—increased 48 percent. Imports fell by 8 percent because of foreign exchange shortages, high import taxes, and direct import controls. [redacted] 25X1

Despite the narrowing of the current account deficit, a severe foreign exchange crisis was headed off only by an influx of IMF funds, debt relief, short-term credits to purchase petroleum, and supplemental aid from Saudi Arabia and the United States. Both states helped close the balance-of-payments gap by providing aid in excess of earlier pledges. Total Saudi and US aid disbursements amounted to $178 million and $140 million, respectively. 25X1 Nonetheless, the payments situation remains troublesome. According to the US Embassy, Sudan apparently has run up a petroleum debt of $900 million. With additional credit hard to obtain, severe fuel shortages could occur early next year. [redacted] 25X1

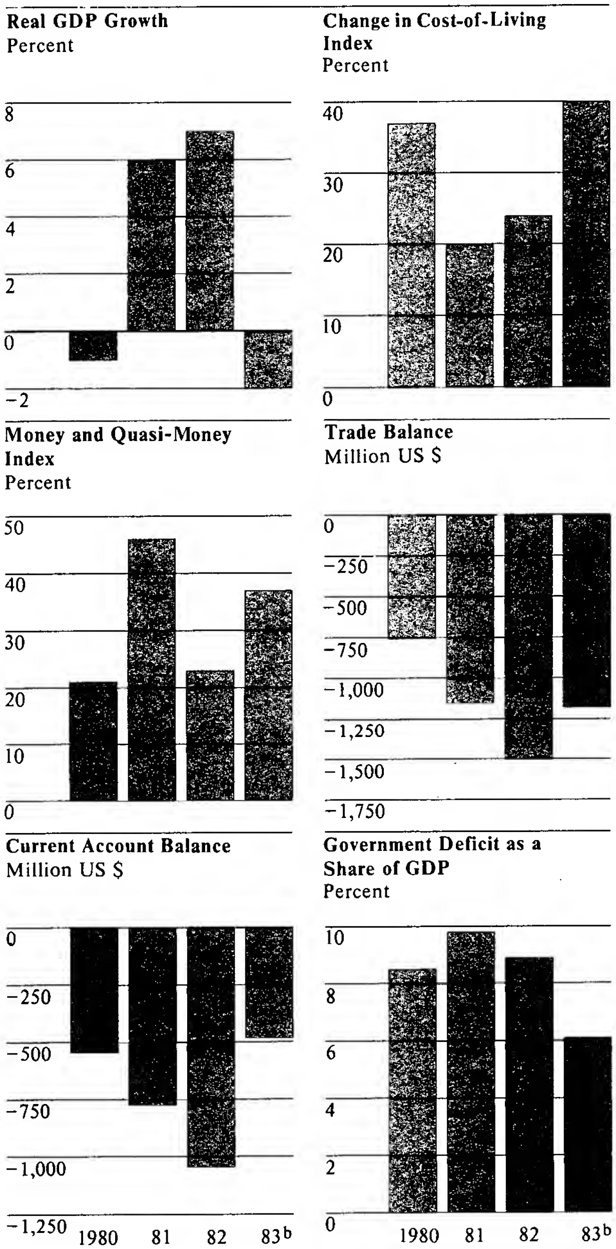
Dealing With Debt and the IMF

Sudan's external debt is approaching $9 billion—an amount exceeding the country's annual GDP. Debt reschedulings in 1979 and 1982 have proved inadequate, in part because the Sudanese Government was unable to provide an accurate record of the country's total debt. The IMF and donors now recognize that the debt problem can only be dealt 25X1 with through yearly IMF standbys and annual debt reschedulings probably for the next several years. [redacted] 25X1

Sudan is currently operating under an IMF standby agreement reached in February 1983 worth $180 million. The government has remained in

Sudan: Economic Indicators[a]

Note scale change



[a] Fiscal years end in June.
[b] Estimated.

[redacted]

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compliance with Fund conditions that encourage exports, discourage imports, reduce the government deficit, slow monetary growth, and make greater use of the free market exchange rate. [redacted] 25X1

Prospects for next year's IMF program, however, remain clouded. An IMF team went to Khartoum last month to negotiate another one-year standby that will make possible a Paris Club rescheduling of debts coming due in 1984. The team left, however, without reaching agreement. Sudanese negotiators were unwilling to accept new IMF guidelines that include further revenue increases and expenditure cuts, slower monetary growth, and the shift of more exports from the official exchange rate to the free market exchange rate. Embassy sources report that the major hurdle is the government's unwillingness to take action on the domestic revenue issue; Finance Minister Mansour is reluctant to implement new taxes on top of recent increases. [redacted] 25X1

The Sudanese Government would like to avoid further exchange rate reforms because it will raise domestic prices. The IMF wants Sudan to move more commodities from the official rate—one Sudanese pound (£S 1) equals US $0.77—to the free market exchange rate in lieu of an official devaluation. Sudanese officials have cited the recent appreciation of the pound on the free market as evidence that the economy is improving and that future exchange reform is unnecessary. The rate rose from £S 1 equals $0.48 in August to $0.57 in mid-October. In our view, the free market increase is temporary and results from a lack of demand stemming from an August ban on imports of nonessential goods. [redacted] 25X1

Sudan is resisting the changes because moving transactions from the official exchange rate to the free market rate will require restructuring Sudan's public sector. The IMF and donors are focusing on the petroleum sector; oil purchases represent 25 percent of Sudan's import bill. Mismanagement and price controls have created persistent fuel shortages and a thriving black market. According

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Sudan: Current Account [a]

Million US $

	1980	1981	1982	1983 [b]
Current account balance	**−547.2**	**−774.7**	**−1,045.1**	**−482.8**
Trade balance	−758.4	−1,152.5	−1,503.5	−1,179.2
Exports (f.o.b.)	581.5	478.9	381.2	563.3
Imports (c.i.f.)	1,339.9	1,631.4	1,884.7	1,742.5
Services	−82.0	−48.8	−65.1	−38.2
Receipts	261.1	328.5	503.0	534.4
Payments	−343.1	−377.3	−568.1	−572.6
Interest	−70.5	−105.2	−190.2	−169.2
Transfers (net)	293.2	426.6	523.5	734.6
Private	209.0	304.6	350.0	430.0
Official	84.2	122.0	173.5	304.6

[a] Data for fiscal years ending in June.
[b] Estimated.

[redacted] 25X1

to US Embassy sources, the present system also is a significant source of graft for officials in the Ministry of Energy and the Presidential Palace. [redacted]

As an inducement for turning Sudan's General Petroleum Corporation over to private companies, USAID is prepared to offer a conditional $40 million Commodity Import Program grant for oil imports in 1984. The Finance Minister and some government officials agree that moving petroleum to the free market would have substantial benefits, but other Sudanese officials with vested interests in the current arrangement do not support the changes. Acceptance of the plan by Energy Minister Tahami will be particularly difficult since he is reported by Embassy sources to be a prime benefactor of oil-market corruption. [redacted]

Divestiture of public enterprises would be a significant step toward loosening government control over the economy and shrinking the budget deficit. Most commodities distributed by public corporations are priced below their market value and these subsidies are a significant drain on the government budget.

The government, however, is reluctant to raise official prices because of a fear that disturbances might result. Returning these government operations to the private sector would raise stated prices but could eliminate the extensive black markets where even higher prices prevail. [redacted] 25X1

25X1

As a possible attempt to satisfy the IMF, the state-owned Sudan Airways was disbanded by presidential decree in early November and converted to a private company. It remains to be seen whether this is the first of a series of moves to lessen government participation in the economy, or whether it is designed merely to reduce IMF and donor pressure for privatization in areas such as petroleum. [redacted] 25X1

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Outlook

Despite government objections to IMF conditions, Sudan's financial problems almost certainly will

force Khartoum to reach an agreement on a new standby loan before the 1983 agreement expires in February. An IMF agreement is an essential prerequisite for further debt relief and high levels of donor aid. More intensive negotiations between the IMF and Khartoum are expected before an agreement is nailed down. [redacted] 25X1

During his visit to Washington, President Nimeiri almost certainly will request continued high levels of US aid. Nimeiri probably will underscore the economic improvements expected in 1986 when the oil export pipeline is completed. He also may seek US help to dilute proposed IMF reforms. Nimeiri will hope that the strategic importance of Sudan will be sufficient to garner further US support. [redacted] 25X1

[redacted] 25X1

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